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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. ——

JOHN H. BINGLER, DISTRICT DIRECTOR OF INTERNAL REVENUE, PETITIONER

v.

RICHARD E. JOHNSON, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of John H. Bingler, District Director of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in these cases.

OPINIONS BELOW

The district court's instructions to the jury are not officially reported. They are unofficially reported at 19 A.F.T.R. 2d 426. The opinion of the court of appeals (Appendix B, *infra,* pp. 5a–17a) is not yet officially reported. It is unofficially reported at 21 A.F.T.R. 2d 1418.

JURISDICTION

The judgment of the court of appeals (Appendix B, *infra,* pp. 18a–19a) was entered on June 5, 1968.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Income Tax (1954 Code) are set forth in Appendix A, *infra*, pp. 1a–3a.

QUESTION PRESENTED

Whether amounts, measured by prior salary and family size, paid by Westinghouse Electric Corporation to selected employees to whom Westinghouse had granted an educational leave of absence for the purpose of completing a doctoral dissertation, and who were obligated to continue in Westinghouse's employ for at least two years after the leave, are excludable from the recipient's gross income as a "scholarship" or "fellowship" within the purview of Section 117 of the Internal Revenue Code of 1954?

STATEMENT

Respondents[1] were employees of the Bettis Atomic Power Laboratory in Pittsburgh, Pennsylvania, which Westinghouse Electric Corporation operates under a cost plus contract with the Atomic Energy Commission (R. 95a–96a).[2] Each respondent partici-

[1] Messrs. Johnson, Pomerantz and Wolfe are referred to herein as "respondents". Their wives are parties solely because joint tax returns were filed for the years in question.

[2] "R.***a" refers to the appendix to respondents' brief in the court of appeals. "R.***b" refers to the appendix to the government's brief in that court. "Tr." refers to the trial transcript.

pated in the Westinghouse Bettis Fellowship and Doctoral Program, one of a variety of training programs that Westinghouse offers to its employees (Tr. 226). This particular program is limited to engineers employed at the Bettis Laboratory who wish to seek a Ph. D. in mechanical or metallurgical engineering at either the University of Pittsburgh or Carnegie Institute of Technology (R. 78a–79a, 95a; Tr. 33, 124, 227–229). The program is funded primarily by the AEC under its general contract for the operation of the Bettis Laboratory (Tr. 236). Officials of Westinghouse and the AEC testified at trial that because of a severe shortage of qualified nuclear scientists and engineers, the Bettis Doctoral program was established in about 1956 to attract engineers and scientists and to aid in meeting the needs of Westinghouse for key professional personnel (R. 78a, Tr. 154, 155, 219). To the date of trial, approximately 60 Westinghouse employees had obtained doctorates through the Bettis program (Tr. 222).

Bettis engineers who participate in the program first enter a "work-study" phase, when they work full time at Westinghouse and study part time[3] at either the University of Pittsburgh or Carnegie Institute of Technology (R. 79a–85a). Those who thereby complete all preliminary requirements for a doctorate—*i.e.*, course work, language studies, and qualification examinations—may apply for an "educational" leave

[3] Westinghouse allows its employees up to eight hours per week (up to 156 hours each year) of paid "released time" in which to attend classes (R. 82a, 83a).

of absence in which to complete a dissertation. Each applicant—and the topic of his proposed thesis—must be approved by Westinghouse and by the AEC (R. 4b, 5b, 12b–15b, Tr. 228–229, 273–276). Strict controls are employed to ensure the relationship of thesis topics to the work program of the laboratory (R. 4b, 5b, 12b–15b, Tr. 228–229, 273–276). Those selected must agree to work at Bettis for at least two years after completion of the leave (R. 90a–91a, Tr. 32, 33; Defendants' Exhibits 1, 3, Tr. 63, 119). While on educational leave an engineer receives a so-called "living stipend"—a fixed percentage of his prior salary at Westinghouse plus amounts that depend on the size of his family, up to a fixed maximum (R. 87a, 88a).

Westinghouse's internal records designate those on educational leave of absence as employees of the Bettis Laboratory. The "living stipends" are charged to the indirect labor overhead of the laboratory, and Westinghouse treats these amounts as wages for withholding and Social Security tax purposes (R. 7b, 8b). Those on leave retain their seniority status (Tr. 253, 254) and receive all employee benefits, such as hospitalization, insurance, and stock option privileges (R. 5b). They continue to contribute to and accumulate rights under the Westinghouse pension plan—and they are eligible for vacation immediately upon return from leave (R. 5b).

After successfully completing the work-study phase of the Bettis program, each of the three respondents was granted a leave of absence for the purpose of pursuing thesis topics that Westinghouse and the

AEC had approved. During leaves of nine months, respondents Johnson[4] and Pomerantz[5] were each paid $5,670, representing 80% of their prior salaries at Westinghouse. Respondent Wolfe, whose leave lasted a year,[6] received $9,698.90, which amounted to 90% of his prior salary (Tr. 30, 31, 32).

Westinghouse withheld income tax from these amounts. Respondents filed claims for refund, contending that the payments were excludable from gross income as scholarships under Section 117 of the Internal Revenue Code of 1954 (Appendix A, p. 1a–2a). The Commissioner of Internal Revenue rejected these claims, and timely refund suits were brought in the district court.

At a consolidated trial, the court instructed the jury that:

> amounts of money or stipends paid to an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity * * *. [R. 61a.]

The instructions continued, however, to say that a scholarship or fellowship does not include an amount that either represents "compensation for past, pres-

[4] Respondent Johnson was on leave from October 1, 1960 to June 30, 1961 (Tr. 30).

[5] Respondent Pomerantz was on leave from November 1, 1961 to July 31, 1962 (Tr. 31).

[6] Respondent Wolfe was on leave from March 1, 1960 to February 28, 1961 (Tr. 31).

ent or future employment services, or represents payments for services which are subject to the direction or supervision of the grantor" or are "paid to an individual to enable him to pursue studies or research which studies or research are primarily for the benefit of the grantor * * *." (R. 61a, 62a.)

In answer to special interrogatories, the jury found that the amounts received by each respondent from Westinghouse did not constitute excludable scholarships or fellowships (R. 96a). Judgment accordingly was entered in favor of the District Director.

On appeal the Court of Appeals for the Third Circuit reversed, holding that the amounts paid to respondents during their educational leaves of absence were excludable, and that the issue should not have been submitted to the jury.[7] The court reasoned that even if a payment had "'indicia of compensation'", it could nonetheless be characterized as an excludable scholarship. Accordingly, the court disapproved (App. B, p. 10a) the provision of Treasury Regulation § 1.117–4(c)(1), which states that Section 117 does not encompass amounts that represent (App. A, p. 3a) "compensation for past, present, or future employment services." It also ruled that the amounts paid respondents were not compensation for future employment at Westinghouse, since respond-

[7] Because respondents did not move for either a directed verdict or judgment n.o.v. at trial, we interpret the decision below as calling for a new trial and not the entry of judgment for respondents. See, *Globe Liquor Co.* v. *San Roman*, 332 U.S. 571; *Cone* v. *West Virginia Paper Co.*, 330 U.S. 212; *Johnson* v. *New York, N.H. & H.R. Co.*, 344 U.S. 48, 54 n. 3.

ents, after completing their doctorates, were to be paid at a rate commensurate with their then education and experience. Finally, the court held (App. B, pp. 14a–16a), that whatever "indirect advantage" the Bettis program gave Westinghouse was beyond the scope of Regulation Section 1.117–4(c)(2), which states that amounts "paid or allowed to * * * an individual to enable him to pursue studies or research primarily for the benefit of the grantor" are not a "scholarship" or "fellowship".

REASONS FOR GRANTING THE WRIT

1. The decision of the Third Circuit in this case is in conflict with decisions of the Courts of Appeal for the Fifth and Sixth Circuits and of the Court of Claims. In *Ussery* v. *United States*, 296 F. 2d 582, the Fifth Circuit held that Section 117 did not allow a taxpayer to exclude from gross income monthly stipends he received from the Mississippi Department of Public Welfare, which had granted him educational leave while he secured his Master's Degree in social work, and to whose employ he was required to return upon completion of his studies. In sustaining Section 1.117–4(c)(2) of the Regulations as a reasonable interpretation of the statute, the court reasoned (296 F. 2d at 586) "that the terms 'scholarship' and 'fellowship' were used as opposed to a term such as 'compensation' and were carefully selected to bar cases where a payment is made for work primarily for the benefit of the grantor." The payments in question were held to fall within the barred category, because the purpose of the program was to train employees

so that they could benefit the Department of Welfare by performing their duties more effectively (*ibid.*).

Stewart v. *United States*, 363 F. 2d 355 (C.A. 6), concerned a taxpayer who received an educational leave and grant from the Tennessee Department of Public Welfare to pursue a Master's Degree in social work. The Sixth Circuit ruled that the payments were includable in gross income because various "indicia of compensation"—such as a contractual obligation to return to the employ of the Department upon completion of leave, and the retention of civil service status and retirement and other fringe benefits—made the payments such "compensation for past, present, or future services" as Section 1.117-4(c)(1) of the Regulations excludes from the definition of "scholarship" and "fellowship".

In like manner, the Court of Claims decided in *Reiffen* v. *United States*, 376 F. 2d 883, that gross income must include amounts paid to an employee of MIT's Lincoln Laboratory who was assigned no work responsibility during an eight month period while he was a full time graduate student, completing research and other requirements for a Ph. D. in electrical engineering. Because the primary purpose of the program was to enable Lincoln to compete with industry and other organizations in the recruitment and retention of scientific and professional personnel, the court, resting on and approving Regulation Section 1.117-4(c), held that Lincoln's payments were made to

enable the engineer to pursue studies and research primarily for the benefit of Lincoln.[8]

2. The Third Circuit has incorrectly construed the statute and unjustifiably rejected the interpretation set forth in the pertinent Treasury Regulation. The decisions of the Fifth and Sixth Circuits and the Court of Claims are correct.

Prior to 1954, no statutory provision explicitly dealt with scholarships and fellowships. The policy of the Internal Revenue Service was founded on the general terms of Sections 22(a) and 22(b)(3) of the 1939 Code. Thus the Service concluded that an amount labeled "scholarship" or "fellowship" would fall within the all-encompassing definition of "gross income" in Section 22(a) unless it qualified as a "gift" within the meaning of Section 22(b)(3). See I. T. 4056, 1951–2 Cum. Bull. 8.

With a view to alleviating the difficulties of a rule that required a case-by-case inquiry into the question whether a "gift" was intended,[9] Congress wrote Sec-

[8] The decision below is also at odds with the reasoning of *Woddail* v. *Commissioner*, 321 F. 2d 721, 724 (C.A. 10) (gross income includes money the Veterans Administration paid a resident in psychiatry and neurology who promised to remain a Veterans Administration employee for a specified time for each year of resident training, because "it was an amount paid for services and was primarily for the benefit of the grantor"), and *Reese* v. *Commissioner*, 373 F. 2d 742 (C.A. 4), affirming *per curiam* 45 T.C. 407 (taxpayer failed to show that $1,900 received while teaching to satisfy a requirement for a master's degree was paid primarily to further her education rather than to compensate her for services rendered).

[9] Compare *Ti Li Loo* v. *Commissioner*, 22 T.C. 220, and *Evens* v. *Commissioner*, 1961 T.C.M. 179, with *Stone* v. *Commissioner*, 23 T.C. 254.

tion 117 into the 1954 Code. (H. Rep. No. 1337, 83d Cong., 2d Sess. 16; S. Rep. No. 1622, 83d Cong., 2d Sess. 17). Section 117(a) states that "gross income does not include * * * any amount received * * * as a scholarship * * * or * * * as a fellowship grant * * *." There is not, however, any statutory definition of the words "scholarship" and "fellowship".

Scholarships and fellowships are, of course, amounts paid to support a student or scholar while he is pursuing studies or independent research, and this is the position taken in the relevant Treasury Regulations. See Treas. Regs §§ 1.117–3(a) and (c). It is equally clear, on the other hand, that a payment is not a scholarship or fellowship merely because it contributes to the support of a student or researcher. At the very least, as the court of appeals recognized in the present case (App. B, pp. 13a–14a):

> A significant commitment by the student in return for a grant would, of course, place that grant outside the category "scholarship", at least to the extent of the value of that commitment. For if the grantee had to barter for his stipend, giving full value for it, this arrangement would hardly serve the primary purpose of the § 117 exclusion: to encourage financial aid to education through tax relief.

To the extent that Congress could foresee such arrangements it expressly forbade or limited the tax exemption. Section 117(b)(1) specifically provides that the "scholarship" exclusion does not apply to payments made for teaching, research, or other services in the nature of part time employment required

as a condition to receiving the grant. The committee reports expressed an intention to tax grants that are, in effect, merely continuing salary payments to non-degree candidates while on leave from a regular job. H. Rep. No. 1337, 83d Cong., 2d Sess., 16–17; S. Rep. No. 1622, 83d Cong., 2d Sess., 17–18. Accordingly, non-degree candidates are allowed to exclude from gross income only grants paid by governmental agencies or charitable, educational and other tax-exempt "organizations described in Section 501(c)(3)," and then only in the amount of $300 for each month of the grant's duration, for a maximum of three years. See Section 117(b)(2).

The thrust of the legislation is clear: Generally speaking, amounts paid for the support of a scholar constitute an excludable scholarship or fellowship. On the other hand, amounts that relate to the provision of services or some other *quid pro quo* by the recipient must be included in gross income. Accordingly, the regulations carve out two basic exceptions from the general definition of excludable scholarships and fellowships cited above: tax exempt treatment is denied (Treas. Reg. § 1.117–4(c), App. A, p. 3a) to amounts that represent either "compensation for past, present, or future employment services," or amounts that finance education or research that is undertaken primarily for the benefit of the grantor.

These regulations, which four circuits and the Court of Claims have sustained,[10] are plainly reasonable "contemporaneous constructions by those charged with administration of these statutes which should

[10] See cases cited pp. 7–9 and footnote 8, *supra*.

not be overruled except for weighty reasons." *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. Their obvious purpose and effect is to deny tax exemption to payments that are essentially compensatory, which accords with the statutory scheme and is in keeping with the ordinary meaning of "scholarship" and "fellowship." "Although study or research undertaken in an educational program may be of benefit to a grantor, the terms 'scholarship' and 'fellowship' connote a purpose of assistance that stands in distinction to the self-interest of an employer in the compensation of his employee." (*Ussery* v. *United States*, *supra*, 296 F. 2d at 585). There is, in consequence, no basis for the Third Circuit's action in overturning (App. B. p. 10a) Section 1.117–4(c)(1) and refusing to apply (App. B, pp. 14a–15a) Section 1.117–4(c)(2) of the Regulations in the manner its words plainly require.

By any of these standards, Westinghouse's payments to respondents should fail to qualify for exclusion from taxation. The opportunity to obtain a doctorate while supported by Westinghouse was part of the overall package of salary and fringe benefits for which respondents bargained when they first entered into Westinghouse's employ (Tr. 115). Working for Westinghouse during the work-study phase was the first requirement of the later, paid leaves of absence. Contrary to the Third Circuit's view (App. B, p. 13a–14a) that respondents made no "significant commitment" and provided nothing "of measurable monetary value," Westinghouse paid so-called "stipends"

on the basis of respondents' commitments to work for two additional years, and the choice of thesis topics that fit into the overall research program of the Bettis Laboratory. The payments were simply continuing salary payments to an employee who was granted leave so that he might upgrade skills required by Westinghouse, requirements that Westinghouse otherwise could not have fulfilled. Westinghouse avoided the need to recruit new people, and respondents surrendered their freedom of choice of employers for a significant period of time. The jury, we submit, had no choice but to find for the government on this record; at the very least the court of appeals should have left standing the jury verdict, which denied tax exemption on the basis of instructions that where substantially in accord with the Treasury's Regulation.

3. Although the exact number of such programs is not known, there are many employers who allow selected employees paid leaves of absence to complete a graduate degree, exacting in return some commitment to return to the employer for a specified minimum period. Companies engaged in advanced technical research and development must offer such benefits if only to compete. Cf. *Reiffen* v. *United States*, *supra*, 376 F.2d at 886. As *Ussery* and *Stewart* demonstrate, these paid leaves of absence are restricted neither to private employers nor to technical personnel.

The Internal Revenue Service has advised us that there are at least 40 pending matters involving the

tax status of payments received by an employee while on educational leave. Many more are sure to arise if the issue is not conclusively settled. For example, in fiscal 1967 alone, more than 500 employees of the United States were allowed paid, educational leaves of absence of one semester or more. The tax rules to be applied to persons in such circumstances will remain unsettled and the Internal Revenue Service and the courts will be unable to accord like treatment to similarly situated taxpayers unless this Court grants certiorari and resolves the uncertainty created by the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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SEPTEMBER 1968.

APPENDIX A

Internal Revenue Code of 1954:

SEC. 117. SCHOLARSHIPS AND FELLOWSHIP GRANTS.

(a) *General Rule.*—In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151(e)(4)), or

(B) as a fellowship grant,

including the value of contributed services and accommodations; and

(2) any amount received to cover expenses for—

(A) travel,

(B) research,

(C) clerical help, or

(D) equipment,

which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

(b) *Limitations.*—

(1) *Individuals who are candidates for degrees.*—In the case of an individual who who is a candidate for a degree at an educational institution (as defined in section 151(e)(4)), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other

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services shall not be regarded as part-time employment within the meaning of this paragraph.

(2) *Individuals who are not candidates for degrees.*—In the case of an individual who is not a candidate for a degree at an educational institution (as defined in section 151(e)(4)), subsection (a) shall apply only if the condition in subparagraph (A) is satisfied and then only within the limitations provided in subparagraph (B).

(A) *Conditions for exclusion.*

The grantor of the scholarship or fellowship grant is—

(i) an organization described in section 501(c)(3) which is exempt from tax under section 501(a),

(ii) a foreign government,

(iii) an international organization, or a binational or multinational education and cultural foundation or commission created or continued pursuant to the Mutual Educational and Cultural Exchange Act of 1961, or

(iv) the United States, or an instrumentality or agency thereof, or a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

(B) *Extent of exclusion.*—The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151(e)(4)).

[26 U.S.C. 1964 ed., Sec. 117]

Treasury Regulations on Income Tax (1954 Code):

§ 1.117–4 *Items not considered as scholarships or fellowship grants.*

The following payments or allowances shall not be considered to be amounts received as a scholarship or a fellowship grant for the purpose of section 117:

* * * * *

(c) *Amounts paid as compensation for services or primarily for the benefit of the grantor.* (1) Except as provided in paragraph (a) of § 1.117–2, any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

(2) Any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research primarily for the benefit of the grantor.

However, amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research are considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (1) of this paragraph. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor shall, of itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant. [26 C.F.R., Sec. 1.117–4.]

APPENDIX B

United States Court of Appeals for the Third Circuit

Nos. 16826, 16827 and 16828

RICHARD E. JOHNSON AND BEVERLY P. JOHNSON, HIS WIFE, AND MARTIN L. POMERANTZ AND PHYLLIS L. POMERANTZ, HIS WIFE, AND RICHARD A. WOLFE AND ANNE F. WOLFE, HIS WIFE

v.

JOHN H. BINGLER, DISTRICT DIRECTOR OF INTERNAL REVENUE

RICHARD E. JOHNSON AND BEVERLY P. JOHNSON, HIS WIFE, APPELLANTS IN NO. 16826

MARTIN L. POMERANTZ AND PHYLLIS L. POMERANTZ HIS WIFE, APPELLANTS IN NO. 16827

RICHARD A. WOLFE AND ANNE F. WOLFE, HIS WIFE, APPELLANTS IN NO. 16828

Appeal From the United States District Court for the Western District of Pennsylvania

Argued January 18, 1968

Before HASTIE, *Chief Judge*, GANEY, *Circuit Judge*, and WEINER, *District Judge*.

OPINION OF THE COURT

(Filed June 5, 1968)

By WEINER, *District Judge*:

Before us on this appeal are three taxpayers [1] who, while employees of the Westinghouse Electric Cor-

[1] Appellants' wives are joined as nominal plaintiff-appellants by virtue of the joint income tax returns filed by them with their husbands for the years involved.

poration, were participants in the Westinghouse Bettis Fellowship and Doctoral Program through which each received a stipendiary grant and leave of absence from his employer in order to research, write, and defend his Ph.D. thesis in engineering at either the University of Pittsburgh or Carnegie Institute of Technology (now Carnegie-Mellon University).

There was testimony below that the Bettis Atomic Power Laboratory, at which each taxpayer was employed before and after his academic leave of absence, is owned by the United States Government and is operated by Westinghouse under a "cost-plus" type of contract with the Atomic Energy Commission. Appellants' theses related to the work program of the Laboratory in the field of nuclear engineering.

Income tax was withheld from the monthly allowances received by each of the three appellants; each filed a claim for refund of this tax on the grounds that the grant was excludable from his gross income as a scholarship under Int. Rev. Code of 1954, § 117. These claims were rejected by the Internal Revenue Service, and again by a jury in the trial below.

The correctness of this determination is the subject of this appeal.

The crucial terms "scholarship" and "fellowship grant" appear in the relevant § 117 without any definition whatsoever.[2] In the absence of any guidance

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[2] In pertinent part, § 117(a)(1) provides as follows:

"(a) General rule.—In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151(e)(4)), or

(B) as a fellowship grant. . . ."

26 U.S.C. § 117(a)(1).

as to the content of these statutory concepts embodied in the Code itself, we agree with the Tax Court that—

> a proper reading of the statute requires that before the exclusion comes into play there must be a determination that the payment sought to be excluded has the normal characteristics associated with the term "scholoraship."

Elmer L. Reese, Jr., 45 T.C. 407, 413 (1966), *aff'd per curiam*, 373 F.2d 742 (4th Cir. 1967). Without attempting a comprehensive definition, we can simply mention some of the more salient "normal characteristics" of such scholarships or fellowship grants that are exemplified in the situation before us.

Appellants' stipends were awarded as subsidies to full-time students, in an amount bearing an appropriate relation to each recipient's needs. Their continuance was contingent upon the participant's maintenance of the academic standards required of a candidate for a graduate degree by the university which each appellant attended. While receiving these grants, appellants were on an academic leave of absence from their employment for the specific purpose of completing their doctoral dissertations. These are the most important positive characteristics which appellants' grants shared with scholarships generically. We turn now to the Code and the legislative history for an understanding of the distinctions with which Congress intentionally colored the kind of grant it wished excluded from gross income for internal revenue purposes.

Most notable in the legislative tax treatment of scholarships is that the Congress in 1954 was painting with a broad brush. Grants which properly qualify as scholarships are excluded from taxation in very unqualified terms by § 117(a). In the case of candidates for a degree, such as appellants before us, this exclu-

sion is explicitly limited in the statute only as not applying—

> to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment, required as a condition to receiving the scholarship or fellowship grant.

Int. Rev. Code of 1954, § 117(b)(1). The statute as it applies to degree candidates provides no ceiling for the amount that the candidate may exclude from his gross income, as long as it otherwise properly qualifies for scholarship tax treatment. This is in sharp contradistinction to the limit of $300 a month for a maximum of 36 months to which those not candidates for a degree are held. *Compare* § 117(b)(1) *with* § 117(b)(2)(B).

The legislative history also evinces unmistakably the intent of Congress to exclude from tax treatment qualifying scholarships without regard to whether they are to be considered "as income or as gifts," H.R. Rep. No. 1337, 83d Cong., 2d Sess. 15 (1954), as had been the test hitherto applied under the then "existing confusion," *id.*, for which the 1954 change was an attempted remedy. The Senate Report, furthermore, carefully sets out the sequence of the thinking that went into § 117:

> The section first states the general rule that amounts received as scholarships or as fellowship grants are excludible from gross income and then prescribes specific rules for limiting the amounts which may be excluded.

S. Rep. No. 1622, 83d Cong., 2d Sess. 17 (1954).

In light of the statutory language and the reports of the Congressional committees which drafted it, the dominant legislative intent evident in the scheme of § 117 is that of encouraging financial aid to students at accredited schools, and especially to candi-

dates for degrees, through the device of limited tax relief. The further attention given by both the statute and the legislative history[3] toward limiting the exclusion only for those *not* candidates for a degree would strengthen the inference, by the canon of statutory construction that *expressio unius est exclusio alterius,* that Congress intentionally included the sole restrictions it wished to place on the excludability of scholarship stipends for degree candidates in the language of § 117(b)(1) itself.

To the sole qualification of § 117(b)(1), then, that degree candidates cannot exclude as tax-exempt scholarships any payment for services required as a condition of the grant, the Treasury Regulations purport to add two others. These would subject to taxation, in pertinent part, any stipend for studies or research which (1) "represents either compensation for past, present, or future employment services"; or which (2) subsidizes studies or research "primarily for the benefit of the grantor." Treas. Reg. 1.117-4(c)(1)-(2), (1956).

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[3] H.R. Rep. No. 1337, *supra* at 17 expressed concern, in the case of non-degree candidates, lest the exclusion extent to any annual grant which, together with "any compensation received from the recipient's previous employer," exceeded 75% "of the recipient's salary in the year preceding the grant." In taxing any amount above this limit, the House committee declared: "This will tax those grants which are in effect merely payments of a salary during a period while the recipient is on leave from his regular job." *Id.* For this percentage exclusion the Senate committee "substituted for the 75 percent rule an exclusion of $300 per month of grants paid to individuals who are not candidates for degrees." S. Rep. No. 1622, *supra* at 18. Both committees evidently foresaw the instant problem and legislated with respect to the type of student and the amount of stipend they wished to subject to a limitation on excludability.

In light of the aim explicit in the legislative history of doing away with the touchstone of compensation versus gift, we cannot say, as one court has, that "indicia of compensation' such as are suggested by the regulation are legitimate criteria for testing the excludability of an alleged scholarship, *cf. Stewart* v. *United States,* 363 F. 2d 355, 357 (6th Cir. 1966). Nor can we even approve the disqualification added by Treas. Reg. § 1.117–4(c)(1) (1956) of amounts which represent "compensation for past, present, or future employment services," without more. *Contra, Ussery* v. *United States,* 296 F. 2d 582, 586–87 (5th Cir. 1961). This ruling seems merely an attempt to write into the regulations a concept which was considered and intentionally rejected by the Congress which enacted the Code.

To summarize: under a fair reading of the Internal Revenue Code of 1954, § 117, in the light of the Congressional committee reports which point up the thinking of the 1954 Congress, we believe that any reasonable stipend which comes within the common understanding of what constitutes a scholarship, is paid to finance the schooling of a degree candidate, and does not fall within the limitation of § 117(b)(1) is excluded from gross income. To illustrate the application of this general outline, we shall take up the Government's arguments in the discussion remaining.

The first element in the Westinghouse Fellowship Program that appears to trouble the Internal Revenue Service is the fact that each grant for those recipients on educational leave was based on a percentage of the grantee's "base salary".[4] The basis on which each

[4] Depending on the family status of the recipient, a Westinghouse Fellow received a stipend of 70% "of the base salary" plus "adders" up to a monthly maximum of $490 if single; 80% plus adders up to $560 monthly if married; 85% plus

Westinghouse Fellowship grant was calculated was, however, not without some logic other than as what might arguably be a disguised salary payment. Scholarships are characteristically based at least partly on need, and the Westinghouse grants were calculated, perhaps generously, to give each recipient a living allowance based upon the size of his family and the standard of living to which his previous salary had accustomed him, without a sudden substantial cut in revenue. Monthly maxima were set; these ceilings do not appear to us to have been excessive or unreasonable—the one limitation most probably implicit in the otherwise unrestricted excludability of scholarships for degree candidates in § 117.

The concept and content of "scholarship" are developing ones. Fundamental in the exclusion afforded such stipends by § 117 is its encouragement toward graduate study. Without an arrangement of subsidies on a sliding scale based on prior income, employees such as appellants here would probably be hard pressed to leave work for a year to return to school to earn an advanced degree. We think the purpose of the instant fellowship program entirely consistent as concerns appellant degree candidates with the scheme of the exclusion afforded scholarships by the Internal Revenue Code of 1954, § 117. There is, moreover, as we have noted above, no ceiling to this exclusion in the statute.

Although the Senate report on § 117 did not discuss the problem of salary payments disguised as educational stipends for degree candidates, it did display concern for this problem with regard to postdoctoral students. In this connection, it notes: "Such grants

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adders up to $595 monthly if married with one child; and 90% plus adders up to $630 if married with two or more children.

may be in effect a continuing salary payment while the recipient is on leave from his regular job," S. Rept. No. 1622, *supra* at 18. The preventive response of Congress, however, was restricted to the $300 monthly limit of § 117(b)(2)(B) for nondegree candidates.

Hence the Westinghouse grants, even based as they were partly on a percentage of each recipient's prior earnings and partly on family size and need, do not seem to us for this reason to disqualify for exclusion either under the statutory language or because of any alleged failure to meet what we consider to be "the normal characteristics associated with the term 'scholarship'."

The second reason advanced by the Government for disqualifying these grants from nontaxable scholarship treatment is that the grantor, Westinghouse, in its own bookkeeping did not denominate them as such: it carried them, rather, as "indirect labor, or overhead." Deductions from the stipend checks, moreover, were regularly made for income tax and social security payments. An evident discrepancy exists between the characterization of these grants both by appellants and by the Fellowship prospectus as "stipends", on the one hand, and by the custodian of the payroll records at the Westinghouse Bettis Atomic Power Laboratory as "indirect labor", on the other.

The answer to this contention by the Government that the grantor's treatment controls, however, has already been given by this circuit in a similar case, where we recently had occasion to—

> observe and emphasize that under this regulation [§ 1.117-4(c)(2)(1956)] the determinative consideration is not the primary purpose of the grantor in subsidizing the student, but rather the primary purpose of and the primary benefit from the subsidized study.

Commissioner v. Ide, 335 F.2d 852, 855 (3d Cir. 1964) (Hastie, J.). Although the court in *Ide* was considering more particularly the taxability of the grants there in question on the grounds that the work done by the grantees was "primarily for the benefit of the grantor," in the words of Treas. Reg. § 1.117–4(c)(2) (1956); nonetheless we believe this observation equally valid as a caution against grafting an additional subjective test based on the grantor's intention onto the existing statutory language which was intended to obviate this inquiry. *Accord, Chandler P. Bhalla,* 35 T.C. 13, 17 (1960) (by implication), *acquiesced in,* 1965–1 Cum. Bull. 4.

The third element of this program to which the Internal Revenue Service objects is the commitment required by the Westinghouse Bettis Fellowship and Doctoral Programs of each participating fellow:

> that after the end of his educational leave he will assume such duties commensurate with his education and experience as may be assigned to him by Westinghouse, and will thereafter continue in the employ of Westinghouse for at least two (2) calendar years at a rate of salary commensurate with the duties assigned.

We do not agree with the Government that this commitment, in this case, is sufficient evidence that these stipends were of an essentially "compensatory nature". Compensation for the future "duties" of each grantee is to be at a "commensurate" salary, presumably without adjustment downwards to take account of the instant grant.

Assuming the above clause to be unenforceable by specific performance, we think it nonetheless apparent that contingent liability in damages for the breach of such a clause might be of substantial value in an appropriate factual situation. A significant commitment

by the student in return for a grant would, of course, place that grant outside the category "scholarship", at least to the extent of the value of that commitment. For if the grantee had to barter for his stipend, giving full value for it, this arrangement would hardly serve the primary purpose of the § 117 exclusion: to encourage financial aid to education through tax relief.

In the instant situation, however, appellants' promise to return to employment with Westinghouse at an appropriate salary would subject them to no financial sacrifice. They are to be paid in accordance with their enhanced educational qualifications. Since a salary commensurate to their new duties is already inducement for them to return to their employer-grantor, appellants' additional paper commitment seems of negligible value in this case.

We of course express no opinion as to cases where the quid pro quo given by the grantee for his grant is of measurable monetary value.

Viewed in a light most adverse to appellants, their situation is still akin to that in *Aileene Evans*, 34 T.C. 720 (1960), *acquiesced in*, 1965–1 Cum. Bull. 4. There the Tax Court held petitioner's stipend excludable from her gross income under § 117, even though she was obligated either to work for her grantor after her studies or to refund the sums advanced. Although petitioner in *Evans* was not an employee of the grantor at the time she received her stipend, we do not deem this distinction material to the hypothetical question of compensation for future employment services.[5]

The last argument advanced by the Government is that appellants' studies were not primarily for the

[5] This we think is true on analysis, despite the cursory attempt to distinguish *Evans* on this point, in Rev. Rul. 65–146, 1965–1 Cum. Bull. 66.

purpose of educating and training each recipient in his individual capacity, but rather in his capacity as an employee of the grantor. The grants, the Government argues, would hence be proscribed by Treas. Reg. § 1.117–4(c)(2) (1956).

To decide this issue, we do not have to consider the validity of this regulation in the light of the statutory language and legislative history of § 117. For the Government's argument is one step removed from the kind of situation the regulation would reach, even assuming it to be a proper construction of the statute. A stipend for studies or research has in the past been disqualified for scholarship treatment because a grantee has performed the function of a paid employee of the grantor, *e.g., Ethel M. Bonn,* 34 T.C. 64 (1960); conversely, a stipend has qualified where a grantee's services "may supplement those of employees of the Institute [connected with the university grantor] but are of themselves not of primary or material benefit to the Institute . . . ." *Wrobleski v. Bingler,* 161 F. Supp. 901, 905 (W.D. Pa. 1958).

In the instant case, however, the Government contends that the grantee's research brings his stipend within the reach of Treas. Reg. § 1.117–4(c)(2)(1956), not because it was primarily of direct benefit to Westinghouse and not to the grantee, but rather because it primarily furthered the education and training of the recipient *qua* Westinghouse employee, and as a corollary redounded to the benefit of Westinghouse by enhancing its engineering program in the competitive market for recruits. Even assuming arguendo, the truth of this contention and the validity of the touchstone of 'primary purpose', nevertheless such indirect advantage as is here alleged has been, and still is, beyond the scope of the regulation.

In summary, we think that the characteristics of what constitutes a scholarship or fellowship grant for the purposes of the Internal Revenue Code are far from clear. The legislative and judicial gloss provides no sure elucidation, *cf. Reese, supra* at 412. *Compare, e.g., Woddail v. Commissioner,* 321 F.2d 721 (10th Cir. 1963) (resident physician receiving residence training in neurology and psychiatry; grant for instruction held taxable) *with Evans, supra* (registered nurse enrolled in psychiatric nursing program on stipend from Tennessee Department of Mental Health for which she will work or to which she will refund stipend; held not taxable).

To us, the nature of the grants here involved is not such as to deprive them of the normal characteristics associated with scholarships or fellowship grants. The single most important purpose that Congress had in mind in enacting § 117 appears through the language of the statute and the Congressional committee reports as that of encouraging financial aid to studies and research, with a preference for the work of degree candidates. In the light of this overriding Congressional goal of encouraging scholarship aid and the accompanying lack of restrictions as to its amount or character in the case of degree candidates, we believe, upon due consideration, that appellants' educational grants do qualify for income tax purposes as excludable scholarships or fellowship grants.

The facts of this case were not in dispute; no question of credibility was presented; no sufficient ground for inconsistent inference of fact was left. As our previous discussion indicates, this case turned on a question solely of statutory construction, requiring only judicial exegesis. Hence the issue below should not have been submitted to the jury, *see Jopek v.*

New York Central R.R., 353 F.2d 778, 783 (3d Cir. 1965); *Kocher v. Creston Transfer Co.*, 166 F.2d 680, 687 (3d Cir. 1948); *Joseph v. United Workers Ass'n.*, 343 Pa. 636, 639 (1942).

The judgment of the district court will be reversed and the case remanded for proceedings not inconsistent with this opinion.

A True Copy:
Teste:

Clerk of U.S. Court of Appeals
for the Third Circuit.

United States Court of Appeals for the Third Circuit

Nos. 16,826 to 16,828

RICHARD E. JOHNSON AND BEVERLY P. JOHNSON, HIS WIFE, AND MARTIN L. POMERANTZ AND PHYLLIS L. POMERANTZ, HIS WIFE, AND RICHARD A. WOLFE AND ANNE F. WOLFE, HIS WIFE

v.

JOHN H. BINGLER, DISTRICT DIRECTOR OF INTERNAL REVENUE

RICHARD E. JOHNSON AND BEVERLY P. JOHNSON, HIS WIFE, APPELLANTS IN NO. 16826

MARTIN L. POMERANTZ AND PHYLLIS L. POMERANTZ HIS WIFE, APPELLANTS IN NO. 16827

RICHARD A. WOLFE AND ANNE F. WOLFE, HIS WIFE, APPELLANTS IN NO. 16828

(D.C. Civil Action No. 65–1033)

On Appeal From the United States District Court for the Western District of Pennsylvania

Present: HASTIE, *Chief Judge,* GANEY, *Circuit Judge,* and WEINER, *District Judge.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the

said District Court, filed December 2, 1966, be, and the same is hereby reversed and the cause remanded for proceedings not inconsistent with the opinion of this Court.

Attest:

THOMAS F. QUINN, *Clerk.*

JUNE 5, 1968.

U.S. GOVERNMENT PRINTING OFFICE: 1968